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SUBJECT: PERU 2008 INVESTMENT CLIMATE STATEMENT

REF: 07 STATE 158802

The following is Embassy Lima's submission of the 2008 Investment Climate Statement for Peru.

Openness to Foreign Investment
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¶1. (U) The Peruvian government seeks to attract investment -- both foreign and domestic -- in nearly all sectors of the economy. The U.S.-Peru Trade Promotion Agreement (PTPA), signed by President Bush and President Garcia on December 14, enables Peru to attract additional investment by clarifying rules for investors, increasing transparency, reducing barriers to trade, establishing faster customs procedures, and improving the dispute settlement process. Peru does not have a bilateral investment treaty (BIT) or tax treaty with the United States, but these provisions are contained in the PTPA. The U.S. Congress extended unilateral trade preferences under the Andean Trade Preferences Act (modified by the Andean Trade Preferences and Drug Eradication Act, or ATPDEA) to Peru, Colombia, Bolivia and Ecuador through February 2008. The U.S. Government recognized Peru's progress on social and economic policy by selecting Peru for the Millennium Challenge Account's Threshold Program for fiscal year 2007.

¶2. (U) During the early 1990s, the Peruvian government promoted economic stabilization and liberalization policies by lowering trade barriers, lifting restrictions on capital flows and opening the economy to foreign investors. Peru experienced marked growth in foreign investment from 1993-1998. Economic reform and privatization slowed in the late 1990s however, leading to a discernible drop in direct and indirect foreign investment flows. Investment remained stagnant following the collapse of President Alberto Fujimori's government in November 2000, and through the period of an interim government and the election of President Alejandro Toledo in 2001.

¶3. (U) During his tenure, President Toledo implemented several pro-investment policies. In April 2002, the government established ProInversion, building on the foundation of COPRI, the privatization agency created in 1991. ProInversion seeks to be a "one-stop shop" for current and potential investors, and has successfully completed both concessions and privatizations of state-owned enterprises and natural resources. In 2004, Las Bambas, a copper deposit, was concessioned to Xstrata TLC, a Swiss company, for USD 121 million plus 19 percent VAT. In 2005, Bayovar, a state-owned phosphate rock deposit, was concessioned to a Brazilian company for a 3 percent royalty, and ProInversion granted British-owned Rio Tinto a concession for the La Granja copper deposit for USD 22 million. Additionally, from January-November 2006, the oil and gas leasing agency Petroperu granted 15 exploration concessions to foreign oil companies, including 8 to 5 U.S. companies, along the northern coast and in the jungle.

¶4. (U) In addition to the 1993 Constitution (enacted January 1, 1994), major laws concerning foreign direct investment in Peru include the Foreign Investment Promotion Law (Legislative Decree (DL) 662 of September 1991) and the Framework Law for Private Investment Growth (DL 757 of November 1991). The two 1991 laws were implemented by Supreme Decree 162-92-EF (October 1992). Two other important laws are the Private Investment in State-Owned Enterprises Promotion Law (DL 674) and the Private Investment in Public Services Infrastructure Promotion Law (DL 758).

¶5. (U) The 1993 Constitution guarantees national treatment for foreign investors and permits foreign investment in almost all economic sectors. Prior approval is only required in the banking (for regulatory reasons, also applies to domestic investment) and defense-related sectors. Foreign investors are advised to register with ProInversion to obtain the guarantee that they will be able to repatriate capital, profits and royalties. Foreigners are legally forbidden from owning a majority interest in radio and television stations in Peru; nevertheless, foreigners have in practice owned controlling interests in such companies. Under the Constitution, foreign interests cannot "acquire or possess under any title, mines, lands, forests, waters, or fuel or energy sources" within 50 kilometers of Peru's international borders. However, foreigners can obtain concessions and rights within the restricted areas with the authorization of a supreme resolution approved by the Cabinet and the Joint Command of the Armed Forces. All investors -- domestic and foreign -- need prior approval before investing in weapons manufacturing industries.

¶6. (U) In 1991, the Peruvian government began an extensive privatization program, encouraging foreign investors to participate. From 1991 through September 2005, privatization revenues totaled USD 9.4 billion, of which foreign investors were responsible for the vast majority. Over three-quarters of these transactions took place from 1994 to 1997. Through September 2005, privatization and concessions proceeds totaled USD 35.1 million, and generated investment commitments of USD 1.3 billion. The government has made only limited progress on privatizations since then, and prospects for future direct privatizations are not encouraging. The government has consequently shifted to a strategy of promoting multi-year concessions as a means of attracting investment into major projects. In 2000, the Lima airport was concessioned to a private group (Lima Airport Partners), and in August 2006, nine of Peru's northern airports were concessioned for 25 years to Swissport. Peru's other airports, as well as various electricity, water, sewage, and oil (Petroperu) companies remain state-owned and operated. In June 2006, the Container Terminal-South Pier of the important seaport of Callao was concessioned for 30 years to a consortium of P and O Dover (U.K.) and Uniport (Spain).

¶7. (U) In June 2004, the Congress passed a law to exclude the state-owned oil company Petroperu from privatization and authorized Petroperu to conduct exploration and production activities. This modified the government's policy since the early 1990s, when it sold all of Petroperu's exploration and production units and a major oil refinery. Under this new law, the government still has an option of granting concessions on remaining Petroperu assets, including one pipeline and several refineries. In July 2006, Congress defeated an executive veto of a bill to "strengthen and modernize" Petroperu. Under the new law, Petroperu can resume exploration, production and

related activities, including petrochemicals; is freed from contracting approval by CONSUCODE, the state procurement supervision agency; is exempted from the approval of its investment projects by the Government Projects Office (SNIP); and will have a worker on its board of directors. Petroperu has a strategic alliance with Brazil's Petrobras.

¶8. (U) Under the 1993 Constitution, foreign investors have the same rights as national investors to benefit from any investment incentives, such as tax exemptions. The PTPA establishes a secure, predictable legal framework for U.S. investors operating in Peru. All forms of investment are protected under the Agreement. U.S. inestors will enjoy in almost all circumstances the right to establish, acquire and operate investments in Peru on an equal footing with local investors.

Conversion and Transfer Policies
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¶9. (U) Under Article 64 of the 1993 Constitution, the Peruvian government guarantees the freedom to hold and dispose of foreign currency; hence, there are no foreign exchange controls in Peru. All restrictions on remittances of profits, dividends, royalties, and capital have been eliminated, although foreign investors are advised to register their investments with ProInversion (as noted above) to ensure these guarantees. Exporters and importers are not required to channel foreign exchange transactions through the Central Reserve Bank of Peru, and can conduct transactions freely on the open market. Anyone may open and maintain foreign currency accounts in Peruvian commercial banks. U.S. firms have reported no problems or delays in transferring funds or remitting capital, earnings, loan repayments or lease payments since Peru's economic reforms of the early 1990s.

¶10. (U) The 1993 Constitution guarantees free convertibility of currency. There is, however, a legal limit on the amount that private pension fund managers can invest in foreign securities. In May 2004, the Central Reserve Bank of Peru (CR) increased this limit from 9 percent to 10.5 percent. The low limit has created local market distortions, trapping liquidity in Peru that is diverted into local equities and bonds, driving up their prices to artificially high levels. The BCR's new board, appointed by the Garcia Administration, intends to gradually raise this limit, beginning with an increase to 12 percent. Under the PTPA, Portfolio managers in the U.S. will be able to provide portfolio management services to both mutual funds and pension funds in Peru, including to funds that manage Peru's privatized social security accounts.

¶11. (U) The BCR is an independent institution, free to manage monetary policy to maintain financial stability. The BCR's primary goal is to maintain price stability, via inflation targeting. Inflation in Peru was 1.6 percent in 2005, 2 percent in 2006, and 1.8 percent in 2007. The government has also implemented policies to de-dollarize the economy, and deposits in the local currency (Nuevo Sol) now account for about 36 percent.

Expropriation and Compensation
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¶12. (U) According to the Constitution, the Peruvian government can only expropriate private property on public interest grounds (such as for public works projects) or for national security. Any expropriation requires the Congress to pass a specific act. The Government of Peru has expressed its intention to comply with international standards concerning expropriations.

Dispute Settlement
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¶13. (U) Dispute settlement continues to be problematic in Peru, although the GOP took steps in 2005 to improve the dispute settlement process. From December 2004 through 2006, the GOP established 24 commercial courts to rule on investment disputes, including two courts of appeal. All of these courts are located in Lima. The commercial courts have substantially improved the process for commercial disputes. Prior to the existence of the commercial courts, it took an average of two years to resolve a commercial case

through the civil court system. These new courts, which have specialized judges, have reduced the amount of time to resolve a case to two months. Additionally, the enforcement of court decisions has been reduced from 36 months to 3-6 months. While about 40 percent of decisions are appealed, most of these are resolved at the appeals level; very few are appealed to the Supreme Court.

¶14. (U) The criminal and civil courts of first instance and appeal are located in the provinces and in Lima. The Supreme Court is located in Lima. In principle, secured interests in property, both chattel and real, are recognized. However, the judicial system is

often extremely slow to hear cases and to issue decisions. In addition, court rulings and the degree of enforcement have been difficult to predict. The capabilities of individual judges vary substantially, and allegations of corruption and outside interference in the judicial system are common. The Peruvian appeals process also tends to delay final decisions. As a result, foreign investors, among others, have found that contracts are often difficult to enforce in Peru. The exposure in 2000 of a network of corrupt judges controlled by Fujimori advisor Vladimiro Montesinos led to promises by subsequent governments to address corruption and reform the judiciary, but progress has been slow.

¶15. (U) Under the 1997 Law of Conciliation (DL 26872), which went into effect on January 1, 2000, disputants in many types of civil and commercial matters are required to consider conciliation before a judge can accept a dispute to be litigated. Private parties often stipulate arbitration to resolve business disputes, as a way to avoid involvement in judicial processes.

¶16. (U) Peru's commercial and bankruptcy laws have proven difficult to enforce through the courts. There is an administrative bankruptcy procedure under INDECOPI (the National Institute for the Defense of Free Competition and the Protection of Intellectual Property), but it has proven to be slow and subject to judicial intervention. The creditor hierarchy is similar to that established under U.S. bankruptcy law, and monetary judgments are usually made in the currency stipulated in the contract.

¶17. (U) International arbitration of disputes between foreign investors and the government or state-controlled firms is included in the 1993 Constitution. Although Peru theoretically accepts binding arbitration, on a few occasions over the past three years, parastatal companies and Government Ministries disregarded unfavorable judgments. Previously, the Government of Peru turned these arbitration cases over to the judiciary, where they were bureaucratically delayed until the companies conceded the cases. However, effective July 2005, the Supreme Court ruled that all arbitration findings and awards are final and not subject to appeal.

¶18. (U) Peru is a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention of 1958), and to the International Center for the Settlement of Investment Disputes (the Washington Convention of 1965). Disputes between foreign investors and the Government of Peru regarding pre-existing contracts must still be submitted to national courts. However, investors who conclude a juridical stability agreement for additional investments may submit disputes with the government to national or international arbitration if stipulated in the agreement. In 2005, the government resolved a high-level dispute by upholding the decision of an arbitration panel and making payment.

¶19. (U) Several private organizations -- including the Universidad Catolica, the Lima Chamber of Commerce and the American Chamber of Commerce -- operate private arbitration centers. The quality of these centers varies, however, and investors should choose a venue for arbitration carefully.

¶20. (U) The U.S.-Peru Trade Promotion Agreement includes a chapter on dispute settlement. The core obligations of the Agreement, including labor and environment provisions, are subject to the dispute settlement provisions of the agreement. Dispute panel procedures set high standards of openness and transparency through open public hearings; public release of legal submissions by parties; special labor or environment expertise for disputes in

these areas; and, opportunities for interested third parties to submit views. The Agreement emphasizes promoting compliance through consultation and trade-enhancing remedies.

## Performance Requirements and Incentives

¶21. (U) Peru offers both foreign and national investors legal and tax stability agreements to stimulate private investment. These agreements guarantee that the statutes on income taxes, remittances, export promotion regimes (such as drawback), administrative procedures, and labor hiring regimes in effect at the time of the investment contract will remain unchanged for that investment for 10 years. To qualify, an investment must exceed USD 10 million in the mining and hydrocarbons sectors or USD 5 million in other sectors within two years. An agreement to acquire more than 50 percent of a company's shares in the privatization process may also qualify an investor for a juridical stability agreement, provided that the infusion will expand the installed capacity of the company or enhance its technological development.

¶22. (U) There are no performance requirements that apply exclusively to foreign investors. Legal stability agreements are subject to Peruvian civil law, which means they cannot be altered unilaterally by the government. Investors are also offered protection from liability for acquiring state-owned enterprises.

¶23. (U) Laws specific to the petroleum and mining sectors also provide assurances to investors. However, in 2000, the government modified the General Mining Law, substantially reducing benefits to investors in that sector. Among the changes were: a reduction in the term concessionaires are granted to achieve the minimum annual production; an increase in fees for holding non-productive concessions; an increase in fines for not achieving minimum production within the allotted time; a reduction in the maximum allowable annual accelerated depreciation; and revocation of the income tax exemption for reinvested profits. In 2004, Congress approved a bill charging a 1 to 3 percent royalty on mining companies' sales. The changes do not affect those investors who have signed legal stability agreements with the government. Under the U.S.-Peru Trade Promotion Agreement, Peru agreed to eliminate a measure affecting any sector in which a government concession is needed, such as transportation, energy and mining, that requires U.S. enterprises to buy locally. In the future, U.S. companies will be free to purchase on the basis of price and quality, not origin of goods in these sectors.

¶24. (U) In December 2006, after increased social demands for a share of mining profits, the Garcia Administration and mining companies agreed to a "voluntary contribution" system whereby mining companies will invest in community infrastructure projects. This agreement averted adoption of a more restrictive mining law, allows mining companies to control where they invest their contributions, and ceases to apply if the prices of mined products drop.

¶25. (U) Parties may freely negotiate contractual conditions related to licensing arrangements and other aspects of technology transfer without prior authorization. Registry of a technology transfer agreement is required for a payment of royalties to be counted against taxes. Such registration is automatic upon submission to ProInversion.

¶26. (U) Current laws limit foreign employees to no more than 20 percent of the total number of employees in a local company (whether owned by foreign or national interests), and restricts their combined salaries to no more than 30 percent of the total company payroll. However, DL 689 (November 1991) provides a variety of exceptions to these limits. For example, a foreigner is not counted against a company's total if he or she holds an immigrant visa, has a certain amount invested in the company (currently about USD 4,000) or is a national of a country that has a reciprocal labor or dual nationality agreement with Peru. Foreign banks and service companies, and international transportation companies are also exempt from these hiring limits, as are all firms located in free trade zones. Furthermore, companies may apply for exemption from the limitations for managerial or technical personnel. With the entry into force of the U.S.-Peru Trade Promotion Agreement, Peru has agreed to exceed its commitments made in the WTO, and to

dismantle significant services and investment barriers, such as measures that require U.S. firms to hire nationals rather than U.S. professionals and measures requiring the purchase of local goods.

Right to Private Ownership and Establishment
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¶27. (U) Foreign and domestic entities are generally permitted the right to establish and own business enterprises and to engage in most forms of remunerative activity. Subject to the restrictions listed earlier in this document, both foreign and domestic entities may invest in any legal economic activity -- including foreign direct investment, portfolio investment, and investment in real property. Private entities may generally freely establish, acquire, and dispose of interests in business enterprises. In the case of some privatized companies deemed important by the government, privatization agency ProInversion has included a so-called "golden share" clause in the sales contract, which allows the government to veto a potential future purchaser of the privatized assets.

Protection of Property Rights
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¶28. (U) As noted in the Dispute Settlement section, in principle, secured interests in property (both chattel and real) are recognized. However, the Peruvian judicial system is often very slow to hear cases and to issue decisions, outcomes have been difficult to predict and enforce, and corruption is frequently alleged. The Peruvian appeals process also delays final outcomes of cases. Thus, foreign investors, among others, have found that contracts are often difficult to enforce in Peru. Improving the judicial system is a stated priority of the Peruvian Government.

¶29. (U) Protection of intellectual property rights (IPR) in Peru has improved over the past decade, but still falls short of U.S. and international standards in several areas. Peru remains on USTR's Special 301 "Watch List" due to concerns about continued high rates of copyright piracy, a lack of protection for confidential test data submitted for the marketing approval of pharmaceutical and agrochemical products, and inadequate enforcement of IPR laws, particularly with respect to the relatively weak penalties that have been imposed on IPR violators.

¶30. (U) The Peruvian government agency charged with promoting and defending intellectual property rights is the Institute for the Defense of Competition and Protection of Intellectual Property (INDECOPI, http://www.indecopi.gob.pe), established in 1992. Legislative Decree 822 of 1996 and Andean Community Decisions 344 and 486 protect patents, trademarks, and industrial designs. Copyrights are protected by Legislative Decree No. 822 of 1996 and by Andean Community Decision 351.

¶31. (U) Peru belongs to the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO). It is also a signatory to the Paris Convention on Industrial Property, Geneva Convention for the Protection of Sound Recordings, Bern Convention for the Protection of Literary and Artistic Works, Brussels Convention on the Distribution of Satellite Signals, Phonograms Convention, Satellites Convention, Universal Copyright Convention, the World Copyright Treaty, and the World Performances and Phonographs Treaty and the Film Register Treaty. In December 1994, the Peruvian Congress ratified the World Trade Organization's Agreement on Trade-Related Aspects of Intellectual Property (TRIPs).

¶32. (U) Under the U.S.-Peru Trade Promotion Agreement, Peru agrees to ratify or accede to the following agreements by the date of entry into force of the agreement: the Convention Relating to the Distribution of Program-Carrying Signals Transmitted by Satellite (1974); the Budapest treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedure (1977) as amended in 1980; the WIPO Copyright Treaty (1996); the WIPO Performances and Phonograms Treaty (1996); the Patent Cooperation Treaty (1970) as amended in 1979; the Trademark Law Treaty (1994); and the International Convention for the Protection of New Varieties of Plants (1991)(UPOV Convention). Peru agrees to make a reasonable effort to ratify or accede to the following agreements: the Patent Law Treaty (2000); the Hague Agreement

Concerning the international Registration of Industrial Designs (1999); and the Protocol Relating to the Madrid agreement Concerning the international Registration of Marks (1989).

¶33. (U) Peru's legal framework provides for easy registration of trademarks, and inventors have been able to patent their inventions since 1994. Peru's 1996 Industrial Property Rights Law provides an effective term of protection for patents and prohibits devices that decode encrypted satellite signals, along with other improvements. Peruvian law does not provide pipeline protection for patents or protection from parallel imports. Although Peruvian law provides for effective trademark protection, counterfeiting of trademarks, copyrighted products, and imports of pirated merchandise are widespread. The International Intellectual Property Alliance estimates that the piracy level in Peru for recorded music was 98 percent in 2006, with damage to U.S. industry estimated at USD 53.5 million. IIPA estimates motion picture piracy accounts for 63 percent of the market for a loss of USD 12 million. IIPA considers that software piracy levels dropped slightly to 70% with estimated trade losses due to business software piracy rose in 2006 to $27.0 million.

¶34. (U) Peru's Copyright Law is generally consistent with the TRIPs Agreement. However, textbooks, books on technical subjects, audiocassettes, motion picture videos and software are widely pirated. While the government, in coordination with the private sector, has conducted numerous raids over the last few years on large-scale distributors and users of pirated goods, and has increased other types of enforcement, piracy continues to be a significant problem for legitimate owners of copyrights in Peru.

¶35. (U) Despite increased enforcement actions by INDECOPI, the judicial branch has failed to impose sentences that adequately deter future IPR violations. The Peruvian government in July 2004 increased the minimum penalty for piracy to four years imprisonment, although there have yet to be any convictions under the new law. Peru now has six prosecutors (two fiscalias) dedicated full-time to intellectual property cases. In a major breakthrough, in November 2006, four special courts of first instance and one special appeals court in Lima were assigned IPR duties, effective 2007.

¶36. (U) An IPR Toolkit for Peru can be found on the Embassy and Commercial Service Lima's websites. Besides being a guide to registering and protecting IP, it contains a list of lawyers and other organizations that can provide support on an on-going basis.

¶37. (U) Under the U.S.-Peru Trade Promotion Agreement, in all categories of intellectual property rights (IPR), U.S. companies will be treated at least as well as Peruvian companies, and the agreement makes a number of important improvements to IPR protections. The Agreement provides for improved standards for the protection and enforcement of a broad range of intellectual property rights, which are consistent, both with U.S. standards of protection and enforcement and with emerging international standards. Such improvements include state-of-the-art protections for digital products such as U.S. software, music, text, and video; stronger protection for U.S. patents, trademarks and test data, including an electronic system for the registration and maintenance of trademarks; and further deterrence of piracy and counterfeiting of criminalizing end-user piracy.

## Transparency of the Regulatory System

¶38. (U) The transparency and independence of regulatory processes have become central issues for foreign investors in Peru. Many of the central government entities with which foreign firms must deal -- including the entities that maintain the company registry and supervise securities and exchanges (CONASEV), handle privatization and investment issues (ProInversion), and handle competition policy and intellectual property matters (INDECOPI) -- have procedures that are relatively transparent and predictable. Banks, insurance companies and private pension funds are regulated primarily by the Superintendency of Banking and Insurance (SBS), which is charged with determining the qualifications of potential market entrants and regulating firms once they have begun operations. SBS regulations are also seen as being transparent. Under the U.S. - Peru Trade Promotion Agreement, U.S. financial service suppliers have full

rights to establish subsidiaries or branches for banks and insurance companies.

¶39. (U) When the GOP privatized state-owned monopolies in the areas of telecommunications, electrical generation and distribution, and the hydrocarbons sector in the late 1990s, the GOP established regulatory institutions to oversee the newly private sectors. Delays and lack of predictability in the rulings of these institutions, including OSIPTEL (telecom) and OSINERG (energy), have at times in the past been notable impediments to doing business in Peru.

¶40. (U) In December 2005, OSIPTEL published a new law that lowers Peru's high mobile termination rates to levels comparable to international rates over a 3-year period. Several U.S. companies have encountered problems with the energy sector regulator (OSINERG) over its hesitancy to provide clear regulation for the energy sector. Some regulatory agencies have in the past been subject to politically motivated government intervention in their technical operations.

¶41. (U) U.S. firms have complained that SUNAT's aggressive behavior and interpretation of law are often contrary to the spirit of the law and intent of government policies, complicating normal business operations. The remuneration of SUNAT employees is determined, in part, by the theoretical tax liability they uncover in audits.

¶42. (U) Businesses point out that SUNAT's retroactive reinterpretation of regulations and laws, its levying of disproportionate fines, and initiation of full company audits when companies request a refund or legal revaluation of assets for depreciation purposes, create additional investment and trade barriers. In one case, a U.S. firm requested an improper drawback of USD 1,345, only to face SUNAT fines of USD 645,000. Although the case was resolved, new legislation was needed to correct the problem. In instances involving airline fuels, certain minerals, and other products, SUNAT declared that these goods sold abroad, which under Peruvian government policy are exempted from taxes, were not considered exports and were therefore subject to VAT. Two recent laws were necessary to correct this practice for airline fuels and services. SUNAT often does not follow standard international practice in the way it taxes new activities. To correct these problems, the independent tax tribunals act to check any abuses by SUNAT. In 2004, the GOP established a tax ombudsman who must approve SUNAT's request to appeal adverse tax tribunal decisions. In the past two years, the tax ombudsman has acted in several cases to end unwarranted litigation of disputed assessments. In 2005, a U.S. company won long-standing tax cases against SUNAT as a result of these improvements.

¶43. (U) A 2006 World Bank study found that Peru has significantly lowered the average amount of days it takes to start a business from 98 (2005 study) to 72. Various procedures -- such as obtaining building licenses or certificates of occupancy -- require many steps. Municipal authorities issue most licenses and requirements vary widely by locality. As a result, information on necessary procedures is often difficult to obtain. Business people often complain of excessive red tape; one major foreign investor found that starting project construction and a business required several hundred permits, many of which the responsible government entities were unaware they had to issue. Other investors argue that local governments and municipalities, which are seeking new revenue sources, sometimes withhold licenses or create regulations, thus hindering the ability to do business or making it costlier. Even though import tariffs are substantially lower than previously (the simple average tariff is 8.3 percent ad valorem plus surcharges as of January 2007; the trade-weighted average using 2005 import figures is 5.6 percent), import duties, together with the 19 percent value added tax on goods, high social security tax rates, and certain labor laws, increase investment costs significantly and hinder the efficient mobilization and allocation of investment capital. Businesses can apply for VAT reimbursement.

Efficient Capital Markets and Portfolio Investment
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¶44. (U) Credit is allocated on market terms and the banking industry in Peru is generally considered to be competitive in offering

services to business customers. Private pension funds have competed in recent years with financial companies for bonds issued by companies, as demand for securities greatly exceeds supply. Foreign investors can obtain credit on the local market and several of them have done so in the last few years as terms were more competitive than those of the usual international centers. The private sector has access to a variety of credit instruments. From January through early December 2007, firms placed USD 1.67 billion on the local bond market (compared with USD 1.55 billion in CY 2006), which has been propelled in recent years by demand for investment instruments by private pension fund companies. By November 2007, pension funds managed a total of USD 20.2 billion, a 47 percent surge over the November 2006 level (USD 13.7 billion), thus creating a huge and growing appetite for financial instruments by pension funds. The low 20 percent cap placed by the Central Bank on what the pension funds can invest abroad provides local bond issuers (including the government) and loan seekers with a captive capital market.

¶45. (U) All firms listed on the Lima Stock Exchange (Bolsa de Valores de Lima) or the Public Registry of Securities must be vetted by CONASEV, the National Commission for the Supervision of Companies, Securities and Exchanges, which maintains the Public Registry of Securities and Stock Brokers. CONASEV is the Peruvian government entity charged with the study, promotion, and regulation of the securities and commodities markets, the control of market participants, the maintenance of a transparent and orderly market, the setting of accounting standards and the publication of financial information about covered companies. As part of CONASEV's goal to promote market transparency, to prevent monopolies, and to prevent fraud, issuers of stock are required to inform CONASEV and the relevant stock exchange or body in charge of supervising the centralized trading mechanism, of events that affect or might affect the stock, the company, or any public offerings. Although trading on insider information is technically a crime, no one has been charged and punished under the law.

¶46. (U) Total assets of the commercial banks were USD 29.8 billion at the end of June 2007, 25 percent above the same period of 2006. The banking system is considered generally sound, as it weathered rather well a severe El Nino and global financial turmoil in 1997-98. Sound supervision, combined with competition, led to a significant consolidation in the sector, which still continues. Consequently, 12 commercial banks comprise the system, of which 3 banks account for just over three-fourths of loans and almost four-fifths of deposits. Banks have revamped operations, increased capitalization, and reduced costs in recent years. As of November 2006, foreigners had significant shares in nine banks, of which they were majority owners of four commercial banks (including two of the country's largest). Under the SBS's conservative criteria, 1.3 percent of total loans were assessed as non-performing as of November 2007, down from a high of 11 percent in early 2001. The system also has 3 specialized institutions ("financieras") and 39 thriving micro-lenders and savings banks.

¶47. (U) Larger private firms often use "cross-shareholding" and "stable shareholder" arrangements to restrict investment by outsiders -- not necessarily foreigners -- in their firms. As close families or associates generally control ownership of Peruvian corporations, hostile takeovers are practically non-existent. Peuvian law and regulations do not authorize or encourage private firms to adopt articles of incorporation or association to limit or restrict foreign participation; nor are there any private or public sector efforts to restrict foreign participation in industry standards-setting organizations.

¶48. (U) In 2006, SBS approved a license for the first U.S. company to provide retail credit services, thus increasing competition for incumbent banks and Chilean finance companies.

¶49. (U) Foreign direct investment registered with ProInversion as of the end of 2006 was USD 15.37 billion, compared with USD 15.31 billion a year earlier. ProInversion estimated growth of private foreign direct investment will reach USD 20.00 billion in 2008. Foreign portfolio investment (dematerialized holdings of securities only) totaled USD 9.6 billion in October 2006, up from USD 7.7 billion at the end of December 2005.

Political Violence
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¶50. (U) Although political violence against investors is not a common practice, the mining and petroleum communities witnessed an increase in protests, some violent, in 2005. These leveled off in ¶2006. In September 2007, residents of three northern Piura towns voted overwhelmingly in a referendum to reject mining projects in their region, which has stalled development of a large copper mining project. Other communities around Peru have expressed interest in holding similar referenda. These protests caused several foreign companies to significantly delay or abandon plans to establish operations. Protests against the mining industry occurred for various reasons. Although environmental concerns were often the cited pretext, in many cases protestors were seeking social infrastructure investments not provided by the government. Often times, well-organized groups, such as the Ronderos (local self-defense groups established during the Shining Path terrorist attacks) or NGOs, exaggerated a local community's concerns, bringing in protestors from outside the local community to foment protests against the companies. In at least two incidents in 2005 and 2006, the local mayor and other local authorities led strikes against two large foreign mining companies in an effort to secure additional funds or development promises from the companies. During 2007, there were road blockages and acts of vandalism by groups protesting mining operations, coca growers protesting the Government's eradication policies, and farmers seeking increased government tariff protections and financial support. Some indigenous communities in an oil production area used river and road blockages as a way to press for their demands on a long-standing pollution case. A common thread for many protests is the lack of government provision of basic services such as health and education. Another complaint that can underlie what appear to be environmental protests is a lack of access by local communities to the various "canons," the funds set aside by the government out of the taxes or royalties paid by the oil, gas and mining firms for local community development. In some mining areas, firms and local leaders have alleged that narcotraffickers are fomenting protests as a way to keep prying eyes away from their activities.

¶51. (U) When significant conflicts developed in the first few months of the Garcia Administration, cabinet ministers and often the Prime Minister became personally involved in successfully resolving the protests. The government established a commission in late 2006 to prevent and resolve social conflicts in the extractive industries. In addition, various NGOs have become involved in conflict resolution activities. At the same time, the National Society of Mining and Petroleum (SNMPE), as well as the government, have become involved in assisting local communities to access the extractive industry canons as a way to both stimulate local development and head off social conflict. It is reasonable to posit that many of these efforts should pay off to reduce social conflicts for investors in 2007.

¶52. (U) Political violence remains a concern in the coca-growing regions. The Shining Path (Sendero Luminoso) terrorist organization has become increasingly aggressive and involved in narcotrafficking in these areas. Sendero remnants are presumed to have killed 11 police, 20 civilians, and one member of the military, and committed over 80 terrorist acts in coca-growing areas during 2007. The Shining Path killed eight civilians and five police officers in 2006, and were responsible for 92 serious terrorist incidents that year. In December 2005, the Shining Path killed 13 police officers in several ambushes in coca-going areas of Huanuco and Apurimac. President Garcia continues to reauthorize 60-day states of emergency in parts of Peru's five departments where the Shining Path operates, suspending some civil liberties and giving the armed forces authority to maintain public order.

¶53. (U) There is little government presence in the remote coca-growing zones of the Monzon and the Apurimac-Ene River valleys. The U.S. Embassy in Lima restricts visits by official personnel to these areas because of the threat of violence by narcotics traffickers and remaining columns of the Shining Path. Information about insecure areas and recommended personal security practices can be found at http://www.ds-osac.org/.

Corruption

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¶54. (U) It is illegal in Peru for a public official or employee to accept any type of outside remuneration for the performance of his or her official duties. Peru has ratified both the UN Convention Against Corruption and the Organization of American States' Inter-American Convention Against Corruption. Peru is not a member of the Organization of Economic Cooperation and Development, and has not signed the OECD Convention on Combating Bribery.

¶55. (U) Peru is one of four nations worldwide participating as a pilot country in the G8 anti-corruption and transparency initiative.

The U.S., other G8 partners and NGOs helped the Peruvian government develop an action plan that includes activities in six areas: a) citizen information/internet connectivity; b) improving central government fiscal transparency; c) development of GOP procurement systems; d) improving regional/local government transparency and management; e) improvement of transparency of extractive industry revenues; and f) development of asset forfeiture systems and legislation.

¶56. (U) The G8 initiative has already shown some positive results. A hemisphere-wide state procurement organization - the Inter-American Organization of Government Procurement Institutions - was created under the leadership of Peru's State Procurement Council (CONSUCODE). As of January 2007, eight countries are in the process of adopting the network agreement, prior to its signature (Bolivia, Colombia, Ecuador, Honduras, Mexico, Paraguay, Peru and Paraguay). Also, efforts are underway to provide Internet connections to approximately 90 municipal governments located in areas most affected by terrorism and poverty. The rural connectivity project will allow these governments access to national systems, part of the GOP's E-government initiatives, aimed at creating greater transparency and citizen access to public information.

¶57. (U) U.S. firms have reported only a small number of problems directly resulting from corruption, usually in government procurement processes and in the judicial sector, but the revelation in late 2000 of a broad and deep corruption ring organized by former presidential advisor Vladimiro Montesinos heightened awareness of the problem. Transparency International ranked Peru number 72 (out of 179 countries) in its 2007 Corruption Perception Index. While anti-corruption efforts have been a stated priority of both the Toledo and Garcia Governments, in practice most resources are directed at investigating Fujimori-era corruption. In 2001, President Toledo appointed an anti-corruption "czar" to lead government efforts, but this official resigned in 2002 and has yet to be replaced. Private sector groups have increased efforts to combat corruption through an NGO called "ProEtica," which represents Transparency International in Peru.

Bilateral Investment Agreements
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¶58. (U) Peru has signed bilateral investment agreements with 29 countries (listed below), but not with the United States. The U.S.-Peru Trade Promotion Agreement (PTPA), signed by President Bush on December 14, eliminates the need for a bilateral investment agreement.

Peru's Current Bilateral Investment Agreements
Argentina (1994)
Australia (1995)
Bolivia (1993)
Chile (2000)
China (1994)
Colombia (1994)
Cuba (2000)
Czech Republic (1994)
Denmark (1994)
Ecuador (1999)
El Salvador (1997)
Finland (1995)
France (1993)
Germany (1995)
Italy (1994)
Korea (1993)

Malaysia (1995)
The Netherlands (1994)
Norway (1995)
Paraguay (1994)
Portugal (1994)
Romania (1994)
Singapore (2003)
Spain (1994)
Sweden (1994)
Switzerland (1991)
Thailand (1991)
United Kingdom (1993)
Venezuela (1996)

OPIC and Other Investment Insurance Programs
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¶59. (U) The Overseas Private Investment Corporation (OPIC), an independent U.S. Government agency, offers medium- to long-term financing and political risk insurance. OPIC signed agreements with Peru in December 1992, and in July 1994, OPIC began approving requests for political risk insurance (including for inconvertibility of currency). In 2001, OPIC provided project finance loans of USD 108.4 million. In 2005, OPIC provided USD 800 million worth of insurance coverage for a copper mine and a startup finance company received USD 27 million worth of OPIC insurance coverage. Because of the free convertibility of currency, the U.S. Embassy purchases Peruvian currency for expenses on an as-needed basis, at the market exchange rate. The exchange rate between the U.S. dollar and the Nuevo Sol decreased this past year to under 3 soles. Peru is a member of the Multilateral Investment Guarantee Agency.

Labor
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¶60. (U) Labor is abundant and trainable, although there are shortages of highly skilled workers in some fields and wages for professional staff are high (sometimes higher than U.S. wages in the mining sector for positions in the managerial and consulting fields). On October 1, 2007 the government increased the statutory monthly minimum wage by 10 percent to $176 (550 soles). The law provides for a 48-hour workweek and one day of rest and requires companies to pay overtime for more than eight hours of work per day and additional compensation for work at night. Unions in essential public services, as determined by the government, must provide a sufficient number of workers during a strike to maintain operations. The law bans government unions in essential public services from striking. It also requires strikers to notify the labor ministry in advance before carrying out a job action. According to the labor ministry, one legal strike and 65 illegal strikes took place during the year. According to labor leaders, permission to strike was difficult to obtain, in part because the labor ministry feared harming the economy. The Ministry of Labor justified its decisions by citing unions' failure to fulfill the legal requirements necessary to strike.

¶61. (U) The presence of organized labor in the Peruvian economy has declined; in 2005, 8.6 percent of the labor force was organized. Unemployment in Lima officially stood at 7.2 percent in October 2006, compared with 7.9 percent a year earlier. Surveys show that 53.5 percent of Lima's economically active population was underemployed in the third quarter of 2006, mostly working in the informal sector for below subsistence wages. The statutory monthly minimum wage was raised in January 2006 to 500 soles (about USD 155). Some workers, like miners, are highly paid and also (per statute) receive a share of company profits.

¶62. (U) In 1991-1992, a new labor law and other related statutes replaced extremely inflexible old statutes and regulations. The new

laws allow for multiple forms of unions across company or occupational lines, thus permitting multiple unions in the same company. Workers in probation status or on short-term contracts are not eligible for union membership. Bargaining agreements are considered contractual agreements, valid only for the life of the contract. Productivity provisions must be included in any

collective bargaining agreement. The number of officials and the amount of time union officials may devote to union work with pay is limited to 30 days per year. Unless there is a pre-existing labor contract covering an occupation or industry as a whole, unions must negotiate with each company individually. A laor law passed in July 1995 liberalized hiring. Business leaders lauded the above changes, saying they led to greater efficiency. Labor leaders disagreed, arguing that the new labor laws eroded labor protections and encouraged outsourcing in a way that undercut union activity.

¶63. (U) With Peru's return to democracy in 2000, Peruvian organized labor regained some, but by no means all, of the protections enjoyed in the pre-Fujimori era. A decision by the Constitutional Tribunal in 2004, for example, legitimized collective industry-wide bargaining in the civil construction industry. Labor leaders saw this as a potential precedent to be applied to other activities, but that has not yet happened. Furthermore, new laws added to labor inflexibility because the restrictions for termination and downsizing have made businesses reluctant to hire new employees and have created incentives to outsource.

¶64. (U) Either unions or management can request binding arbitration in contract negotiations. Strikes can be called only after approval by a majority of all workers (union and non-union) voting by secret ballot and only in defense of labor rights. Unions in essential public services, as determined by the government, must provide a sufficient number of workers during a strike to maintain operations.

¶65. (U) The 1993 Constitution provides for a maximum workday of eight hours, with 48 hours as the maximum week. The labor code also sets 24 hours rest per week and 30 days paid annual vacation for all workers. Workers readily sacrifice these and other benefits in exchange for regular employment. Strike activity declined markedly over the ensuing nine years and since new labor laws were passed, worker efficiency rose substantially. However, strikes and militant industrial action increased again in late 2002 and early 2003, with additional strikes in 2004. The overall number of strikes fell in ¶2005. Through October 2005, there were 58 strikes with a loss of 442,586 man-hours, compared with 91 strikes and a loss of 515,480 man-hours in the same period of 2004.

¶66. (U) Congress continues to debate a comprehensive labor law reform, which may result in a return to inflexibility of the conditions of dismissal for employees.

## Foreign Trade Zones/Free Ports

¶67. (U) Peruvian law currently covers two types of free trade zones: export, transformation, industry, trade and services zones (CETICOS), and a free trade zone (ZOFRATACNA) in Tacna. The rules and tax benefits applying to these zones are the same for foreign and national investors.

¶68. (U) Companies established at the CETICOS and ZOFRATACNA, which export no less than 92 percent of their output (more than 80 percent of production for the Loreto CETICOS and more than 50 percent for ZOFRATACNA), are exempted until 2012 from all taxes, dues and contributions to the central government and municipalities, particularly income, sales (IGV), Municipal Promotion (IPM) and excise (ISC) taxes. CETICOS exist at Ilo, Matarani and Paita, with one authorized but not operating at Loreto. There is a concern that the Peruvian Government does not have the proper WTO waivers to validate the CETICOS export requirement. The U.S. automotive industry has expressed a specific concern that U.S. brands are unable to compete with used Japanese vehicles that enter the Peruvian market duty-free through the CETICOS. Importers located in ZOFRATACNA pay only 8 percent customs duties (normal rates are 12 or 20 percent) on 1,086 items sold to retailers in the city of Tacna.

## Foreign Direct Investment Statistics

¶69. (U) The stock of registered foreign direct investment in Peru was USD 15.3 billion in June 2007 according to ProInversion, versus USD 14.3 billion at the end of 2006. ProInversion data place Spanish investors as holding the largest share (30 percent), with

USD 4.7 billion invested. The United States is the second largest investor, with USD 2.6 billion, and the United Kingdom is third, with USD 2.5 billion. However, according to the U.S. Department of Commerce, U.S. registered investment in Peru through December 2006 totaled USD 3.9 billion on a replacement-cost basis. The statistics are skewed because ProInversion records investments on the basis of country registry, rather than control. Thus, an investor registered in the Bahamas, for example, is recorded as British even if the parent is a U.S. company. As a result, U.S.-controlled investment represents a much higher share than the official 17.4 percent. By sector, communications received 31.6 percent of foreign direct investment in 2006, followed by the mining industry (18.7 percent), manufacturing (15.0 percent), and finance (12.5 percent).

¶70. (U) As of the end of 2006, investors had signed 640 legal stability contracts with the Government of Peru through ProInversion. Legal stability contracts commit the government not to apply any future changes in the income tax, labor and other laws governing a specific investment in exchange for commitments to invest a given amount. In addition to these contracts, the Government of Peru has signed numerous tax, foreign exchange and administrative stability contracts through several ministries, mainly the Ministry of Energy and Mines.
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